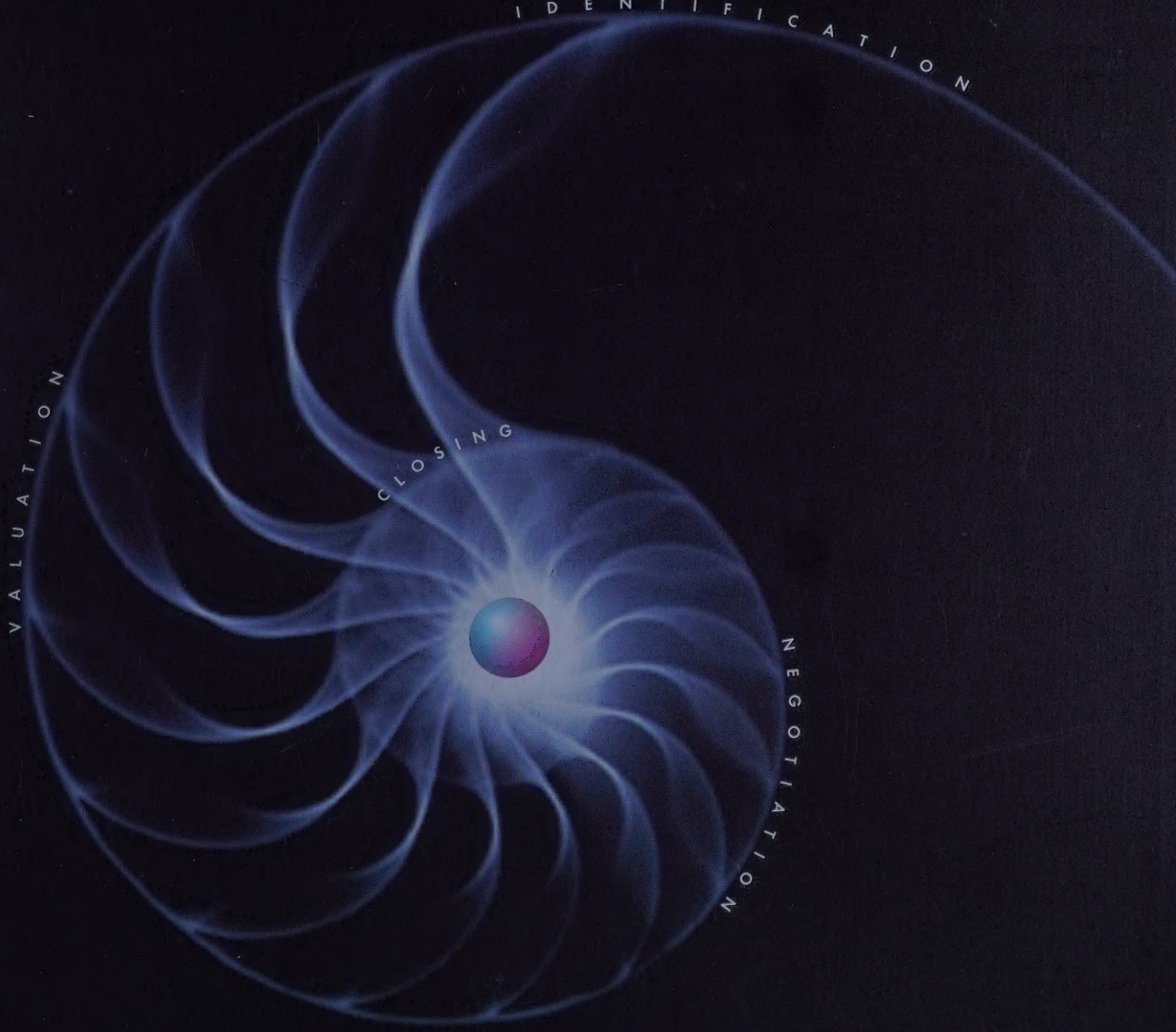


Investing in Innovation

Drug Royalty Annual Report 2001

Drug Royalty's mission is to build an international royalty portfolio of high-growth pharmaceutical products providing investors with the opportunity to diversify into the global healthcare industry without the inherent research, development, manufacturing and marketing risks.

These results demonstrate the value that the royalty model delivers

Financial Highlights

Years ended August 31	2001	2000	1999	1998	1997	1996
STATEMENT OF EARNINGS DATA						
Royalty revenues	**$ 19,348,265**	$ 18,234,869	$ 10,834,810	$ 3,208,217	$ 2,383,711	$ 2,279,801
Fees and gain on sale of royalty interests	**500,172**	678,337	325,893	15,822,009	186,587	12,575,419
Interest and other	**1,250,443**	945,752	667,223	1,687,488	1,139,461	758,111
Net earnings	**6,294,000**	4,002,830	1,804,954	9,234,559	690,057	9,102,575
Basic earnings per share	**0.16**	0.10	0.05	0.29	0.02	0.35
Cash flow from operations	**16,023,880**	14,593,408	8,560,931	16,624,231	2,031,307	14,054,428
Cash flow from operations, excluding fees and gain on sale of royalty interests	**15,945,381**	13,681,293	8,139,223	4,102,818	1,760,940	1,488,211
Cash flow from operations per share	**0.39**	0.36	0.24	0.51	0.07	0.55
BALANCE SHEET DATA						
Cash and equivalents	**25,862,066**	19,040,002	20,059,922	19,790,048	32,019,978	12,634,767
Working capital	**29,564,170**	20,814,842	23,884,368	14,094,245	31,472,102	24,879,620
Royalty interests	**50,563,448**	52,979,293	45,611,677	36,673,122	10,250,474	8,035,187
Shareholders' equity	**81,050,548**	74,613,949	70,447,958	52,799,537	42,017,314	32,954,538
NUMBER OF COMMON SHARES OUTSTANDING	**40,623,806**	40,449,006	40,253,548	32,845,148	31,653,648	25,683,798

James R. Webster, President

Investing in Innovation

Drug Royalty's future success is based on its ability to strengthen its existing portfolio of royalty interests. The management team brings a ruthless focus to potential investments to maintain diversity and balance, while continuing to attract high-quality, innovative and leading-edge products that will have a lasting impact in the area of life sciences. The goal is to focus on our core competencies, identifying and acquiring royalty streams, while seeking out new opportunities within the global biotechnology and pharmaceutical market. Management is committed to delivering growth in revenues and earnings, thereby improving shareholder value.

Fellow Shareholders,

A YEAR IN REVIEW

In 2001, Drug Royalty Corporation achieved record financial results as a direct result of its commitment to enter into strategic investments in quality products and companies that deliver solid growth. Royalty revenue, earnings and cash flow were all substantially ahead of the prior year. We are proud of these results and remain focused on building value for our shareholders.

Net earnings grew by 57% to $6.3 million or $0.16 per share. Revenue for 2001 totalled $21.1 million, an increase of 6.2% over 2000. Cash flow from operations per share grew 10% to $0.39 per share or $16 million, as many of our royalty interests performed in line with or ahead of our expectations.

Like a pharmaceutical company, our royalty portfolio of pharmaceutical and biotechnology products contains products at various stages of development: pre-commercialization products, innovative growth products and more mature pharmaceuticals. In 1995, Drug Royalty invested in Phytogen Life Sciences Inc., a manufacturer of active pharmaceutical ingredients, at an early stage in the company's development. In 1997, Drug Royalty made a larger, follow-on investment. In July 2001 Phytogen's North American partner, Mylan Laboratories, Inc. (NYSE:MYL), received approval from the U.S. Food and Drug Administration (FDA) for its Abbreviated New Drug Application for paclitaxel injection. Drug Royalty's early investment in the commercialization of generic paclitaxel has positioned it to reap significant benefits, as we expect Phytogen via Mylan to become a major participant in this billion dollar market in 2002.

One of our most recent and promising investments in an innovative growth product is a royalty interest in the sales of Remicade®, a new treatment for Rheumatoid Arthritis and Crohn's Disease, marketed by Johnson & Johnson in the U.S. and Schering-Plough outside the U.S. It is our first acquisition in the area of rheumatoid arthritis, and further diversifies our portfolio. Remicade belongs to a new class of agents called TNF-alpha inhibitors that are considered to be a major breakthrough for rheumatoid arthritis treatment. There is tremendous excitement in the rheumatology community and some analysts forecast the potential for the class of TNF-alpha inhibitors to generate sales in excess of US$6 billion by 2005.

In 1999, Drug Royalty made an investment in Schering-Plough's Clarinex® at the time when it was being filed with the FDA and European regulatory authorities. In the past year, there were positive developments related to this royalty interest as the drug received centralized regulatory approval in the European Union (EU), and in February the drug was launched in the United Kingdom and Germany. In the U.S., final marketing approval for Clarinex was delayed due to certain manufacturing deficiencies at Schering-Plough. Once approved in the U.S., we foresee Clarinex-derived royalty revenues as a growing component of our portfolio in 2002 and beyond, as Schering-Plough converts its $3 billion Claritin® franchise to this improved, patent-protected product.

To provide our shareholders with a more detailed look at the rigorous process that Drug Royalty undertakes with all its potential acquisitions, this report contains a first-hand account of the Remicade Agreement. Please see "Remicade: Anatomy of a Deal" on page 7. A complete description of all our royalty interests is contained on page 14 and includes a description of our significant interests in Neupogen® and Taxol®, which also performed well in 2001.

OUTLOOK

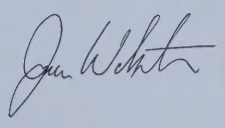
Drug Royalty's solid performance during 2001 is a reflection of the Company's corporate strategy, focused management team, and ability to recognize and respond quickly to emerging opportunities in the pharmaceutical/biotechnology marketplace. We are results-driven and have a clear vision of future growth and sustainable profitability. Drug Royalty's year-end cash position of $26 million, along with a $20 million line of credit, leaves us well positioned to continue our unique approach to portfolio building.

Subsequent to year-end, we announced the acquisition of a new royalty interest in Thalomid® for $4.7 million. This is an important potential new treatment for various cancers, including multiple myeloma, colorectal cancer and renal cell cancer.

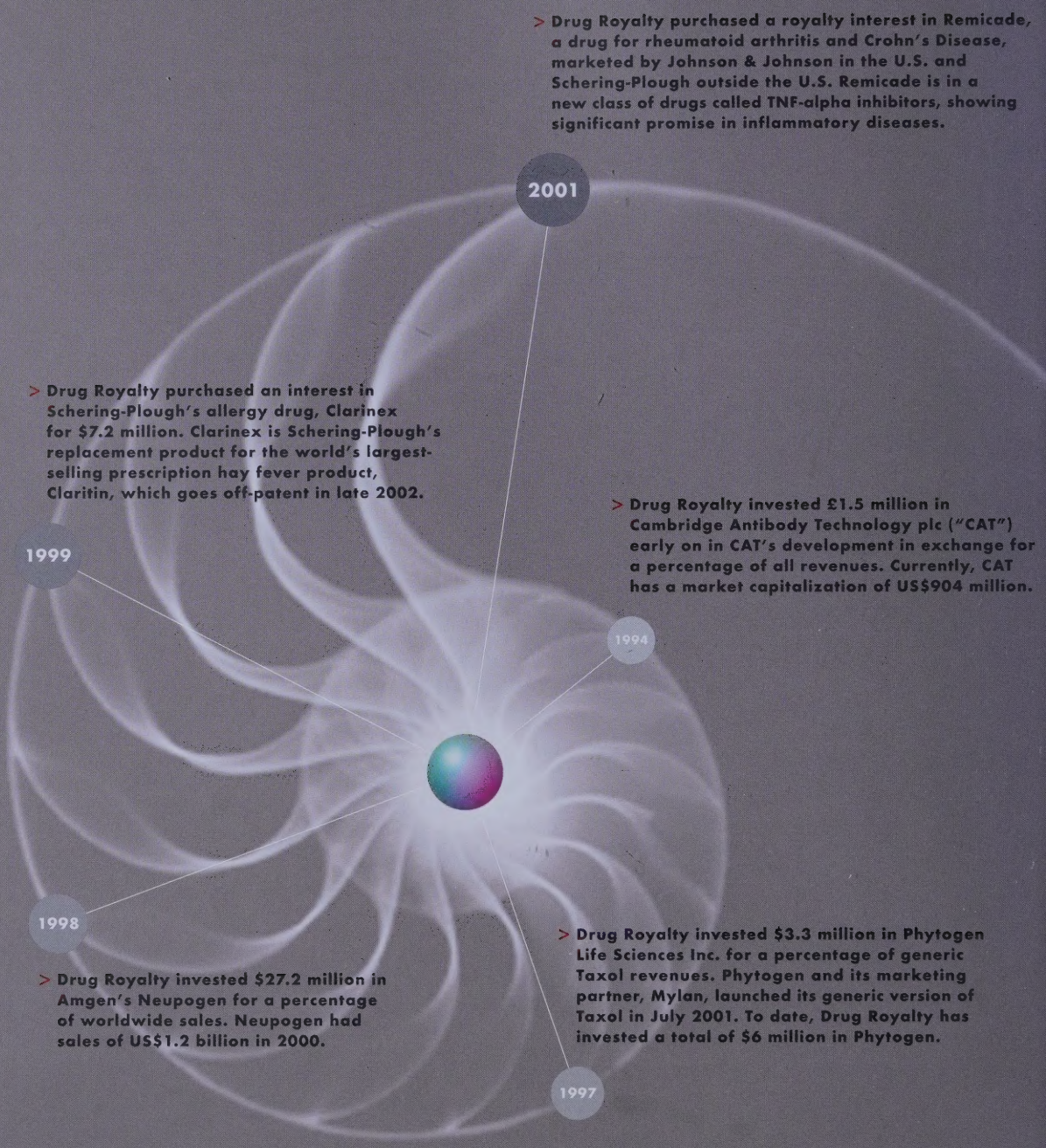
At the time of this report, sentiment about the capital markets and the general economy was decidedly negative. Investors are increasingly looking for companies with realistic commercial prospects. Our management team is planning a renewed emphasis on taking Drug Royalty's excellent fundamental story to the North American investor community in the coming months. With a wider shareholder base, an increasingly stronger portfolio, and a proven growth strategy, we believe that Drug Royalty's prospects are excellent.

On behalf of the Board of Directors and our team, thank you, our shareholders, for your continued support. I look forward to reporting on our progress throughout the year.

Sincerely,



James R. Webster, President
October 31, 2001



The Evolution of Our Strategy

Drug Royalty's business strategy is to identify and negotiate profitable royalty agreements for late-stage and market-ready pharmaceutical products. Through this strategy, Drug Royalty eliminates the large overhead costs associated with pharmaceutical product development, while allowing its shareholders to benefit from significant revenue streams generated by these pharmaceutical products.

Drug Royalty was launched in late 1992 with the vision of participating in the high-growth prospects of the life sciences sector without assuming the inherent volatility of the industry. The model was developed using highly profitable and successful companies in the mining, oil and gas sectors as a template. Drug Royalty's founders wanted to capitalize on the prosperous economic outlook for the sector, mainly due to favourable demographic trends, increased consumerism and high demand for drugs and services to satisfy this growing market. At the outset, Drug Royalty's mandate was to invest in the biotechnology and pharmaceutical industries by creating unique royalty agreements, acquiring existing royalty licenses and revenues, and securing proprietary intellectual property. Over the years, the Company's business model has been re-evaluated and further enhanced to what it is today – a strategy of offering an alternative source of financing to companies, inventors and institutions in the biotechnology/ pharmaceutical sector.

Currently, the worldwide pharmaceutical market is estimated at $300 billion annually. The worldwide royalty market is estimated to be between $7 billion and $10 billion annually, and this market is growing due to the continuous development and burgeoning maturity of the biotechnology sector. Few industries can match the size, growth potential and long-term prospects of the pharmaceutical sector.

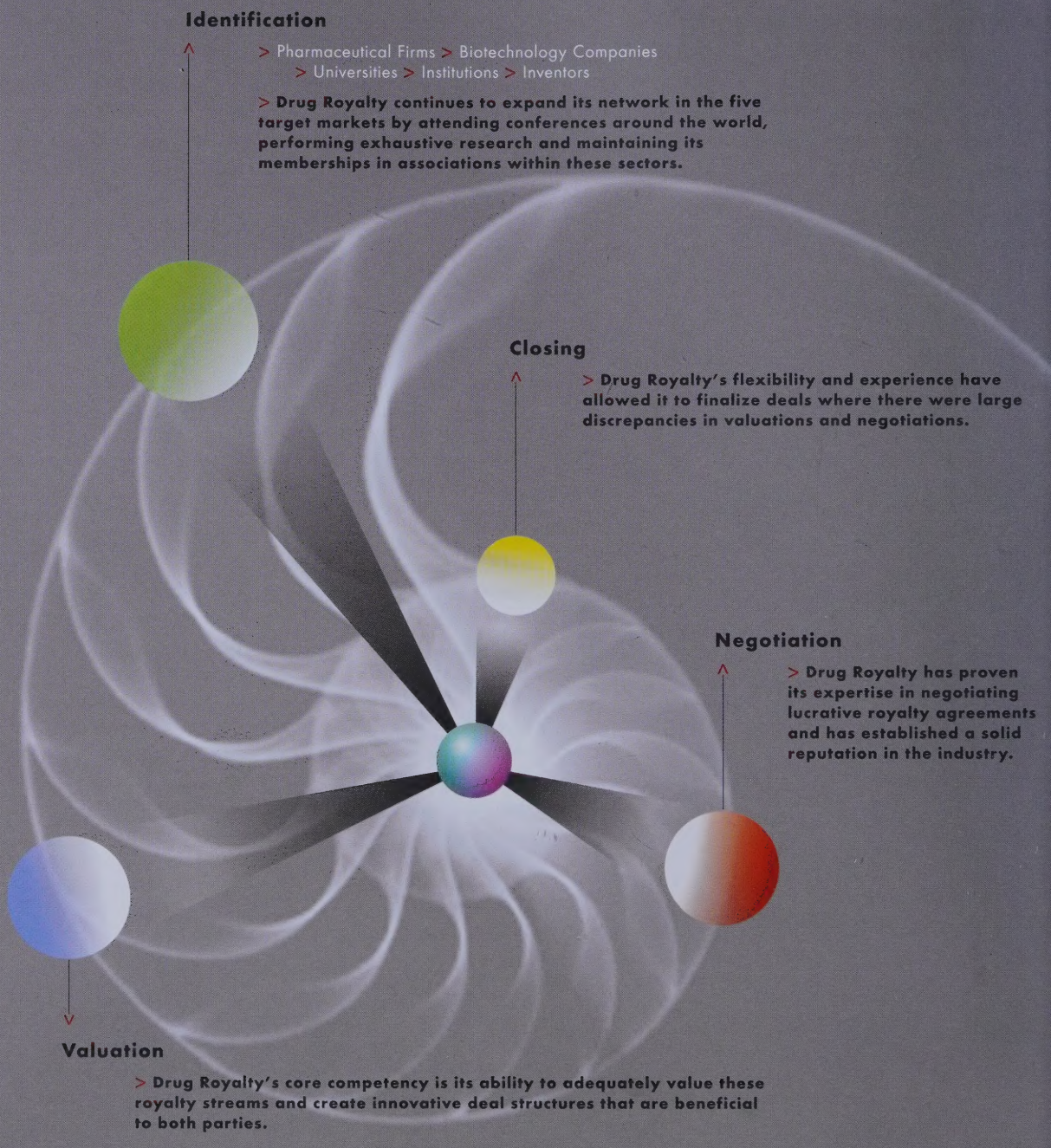
Drug Royalty's target markets consist of large pharmaceutical companies, emerging biotechnology companies, top universities, institutions and inventors. Drug Royalty has acquired royalty streams in each of these markets and continues to develop innovative financing strategies within these parameters.

Drug Royalty focuses on late-stage, high-growth drugs when evaluating a potential addition to its royalty portfolio. With royalty-based financing and by focusing on later-stage drugs, the Company has successfully invested in blockbuster drugs, namely Bristol-Myers Squibb's Taxol, Amgen's Neupogen, and Johnson & Johnson's Remicade, without assuming the risk of research and development, marketing and distribution.

While the pharmaceutical royalty market is innovative and dynamic, it is not without its challenges. A crucial aspect of being successful within this market is identifying royalty obligations, and herein lies one of the greatest challenges for Drug Royalty. Significant time and effort is expended by the Company's small management team in trying to locate potential acquisitions through extensive and exhaustive research and networking activities.

Drug Royalty has been tremendously successful in acquiring a solid, growing royalty portfolio, one with products at various stages of development. The Company recognizes its key strengths: a strong management team that is committed to realizing value for its shareholders, the business acumen to successfully capitalize on its business model, and the ability to identify and acquire solid royalty deals.

Drug Royalty is poised to benefit from new opportunities by utilizing its core strengths – its dedicated team of specialists, its financial resources, its flexibility, and the speed with which it can embrace, enhance and evaluate new ideas and concepts in a changing economic environment.



The Evolution of the Deal

Drug Royalty has invested over $100 million in royalty investments. Our portfolio includes interests on some of the best-selling, fastest-growing and most promising drugs on the market today: Amgen's Neupogen, Bristol-Myers Squibb's Taxol, Johnson & Johnson's Remicade, Schering-Plough's Clarinex and Celgene's Thalomid. We are proud of these investments and look forward to adding the same calibre of products to the portfolio in the future.

REMICADE: ANATOMY OF THE DEAL

Drug Royalty's royalty financing model is driven by the acquisition of existing royalty streams from public institutions, inventors or companies, and creating new royalty contracts by providing funds to pharmaceutical and biotechnology companies in return for a percentage of top line sales.

A recent royalty acquisition, an interest in Johnson & Johnson's rheumatoid arthritis product, Remicade, was completed in April 2001. The securing of Remicade is a classic illustration of Drug Royalty's model in action as it proceeds through basic phases: Identification, Valuation, Negotiation and Closing.

IDENTIFICATION

The first step in this process is the most labour intensive, one with significant time demands, and one where Drug Royalty excels. Our team has the experience and infrastructure required to assess where royalty entitlements exist and the analytical ability to evaluate potential acquisitions.

In late 1999, through extensive research of patent rights and drug development, Drug Royalty identified a royalty entitlement to the inventors of Remicade. In the Spring of 2000, Drug Royalty contacted these inventors with the goal of acquiring the interest. The inventors expressed willingness to sell a portion of their entitlement and Drug Royalty started the valuation process.

VALUATION

Drug Royalty's management team assessed several aspects of Remicade, including the opportunities for the product, current therapeutic trends, patent issues, total market size, potential market share, market competition, scientific results and return on investment.

Rheumatoid arthritis (RA) has not had a significant advancement in therapy for more than 20 years. Remicade was introduced in late 1998 by Johnson & Johnson in the U.S. and by Schering-Plough in the rest of the world as part of a new class of "TNF-Alpha Inhibitors." These were important issues in completing the valuation, although very difficult to quantify.

After gathering as much information as possible through research, consulting with experts, analysts and consultants in the field, and modeling sales forecasts, Drug Royalty determined a valuation. This value was designed to fairly compensate the sellers and provide Drug Royalty with a profitable, secure and valuable royalty stream.

NEGOTIATION

Negotiations started in late November 1999, but were adjourned in March 2000 due to an impasse on valuation.

In October 2000, Drug Royalty contacted the inventors once more to evaluate their current position and to determine if there was still an interest to sell. Drug Royalty updated its model and presented the inventors with an amended proposal for their interest, with minor alterations to the March 2000 offer.

Within a few days, Drug Royalty was once again negotiating for the Remicade royalty entitlement.

CLOSING

The parties reached a definitive agreement in January 2001 that was signed at the end of that month.

The inventors were associated with an institution and the terms of their entitlement required the institution to consent to the sale. The agreement was forwarded to the institution in February 2001. Its approval came back in April 2001. Monies were transferred, hands were shaken and congratulations were given. Drug Royalty received its first royalty payment for Remicade in June 2001.

Rheumatoid arthritis (RA)

RA is a chronic and destructive form of joint inflammation. According to the Arthritis Foundation, the prevalence of RA in the U.S. is 2.1 million people, approximately 1% of the population. There have been no significant advances in therapy for RA patients in over 20 years.

Remicade

Remicade is approved by the FDA for use in treating moderate to severe RA, prevention of joint damage in RA, and moderate to severe Crohn's Disease. It is in a class of drugs called TNF-alpha inhibitors which have proven to be highly effective in treating inflammatory diseases.

Remicade

Remicade earned sales of $370 million in 2000, an increase of 219% over 1999 levels, and had sales of $511 million for the nine months ended September 30, 2001. It continues to add to its market share due to its ease of dosing, ability to halt joint damage and favourable reimbursement profile.

> **Harry K. Loveys**
Executive Vice-President

> **James R. Webster**
President

> **John McCulloch**
Vice-President, Technology

"We are well-positioned to continue our unique strategy and to be opportunistic in building shareholder value."

> **Shermaine Tilley**
Director, Biotechnology/Pharmaceutical Research

> **Petra Decher**
Director, Finance and Secretary-Treasurer

The Involvement of Management

Behind every Drug Royalty deal is an engaged and experienced management team. Our senior managers are all shareholders, focused on value creation through active, disciplined portfolio management. We invest in what we know best – drug royalty streams that have the potential to produce sustained and profitable performance. Collectively, these investments form a portfolio of blockbuster products designed to generate superior returns throughout all business cycles.

While many firms may move hesitantly through today's uncertain economic terrain, we are extremely confident of Drug Royalty's path. The Company is poised to benefit from this environment by deploying key management strengths and assets – business acumen and experience, robust financial resources and the organizational flexibility to recognize opportunities as they arise. Our strong position comes from remaining true to the vision management embraced in creating Drug Royalty in 1992. Then, as today, obtaining royalty streams from pharmaceutical products was a smart, risk-averse method of participating in the rapidly-growing international life sciences sector. The health care industry has expanded for several years, exploring and developing innovative products to fight costly and devastating diseases. Now, the largest pharmaceutical companies face strong pressure to get these products to market ever more quickly, while dealing with lengthy and costly research and development. We believe the industry is in the midst of a major restructuring, to optimize its ability to respond to today's market dynamic.

Drug Royalty's market opportunity is to capitalize on these trends by putting the experience and skills of the Company's management team to work. Jim Webster, President, who joined Drug Royalty when it went public in early 1993, leads the Company. His responsibilities include identifying, assessing and negotiating deals. Jim's strong financial, analytical and corporate development background gives him an unparalleled insight into innovative deal structures, valuation and product opportunities. Jim has a Chartered Accountant designation and an MBA from the University of Western Ontario.

Harry Loveys, Executive Vice-President, came to the Company in 1995 after more than 25 years of pharmaceutical experience at The Upjohn Company in the U.S. and Canada. Harry's intimate knowledge of the industry and regulatory approval processes provide him with an excellent background in business development, diligence and initial contact with potential partners.

John McCulloch, Vice-President of Technology, joined the Company in early 1994. Holding a PhD in Immunology, John's role is to critically analyze and evaluate potential investment opportunities. He focuses on review of clinical data, intellectual property issues and the competitive landscape in his analysis of new investment candidates.

Shermaine Tilley, Director of Biotechnology/Pharmaceutical Research, is primarily responsible for financial modeling and due diligence on investment opportunities. Shermaine formerly held positions as an associate professor at the NYU School of Medicine and the Public Health Research Institute in New York. She also consulted for the NIH Small Business Innovation Research Grant program for 10 years. Shermaine holds a PhD in Biochemistry from the Johns Hopkins University School of Medicine and an MBA from the University of Toronto.

Petra Decher, Director of Finance and Secretary-Treasurer, the most recent addition to our senior management team, brings a strong financial background to Drug Royalty. She joined the Company in 2000 after having spent four years in public accounting. Petra's responsibilities include in-depth financial analysis, regulatory filing requirements and the Company's investor relations activities.

For the coming year and beyond, our team remains resolutely committed to growth. We believe that factors such as falling equity values will heighten the need for large pharmaceutical companies to focus on cash preservation and core competencies, thereby producing a number of royalty opportunities. Drug Royalty is well positioned to examine these opportunities as a result of the resources we have at hand, including a strong cash position. We believe that our top priority during 2002 is to increase our holdings and we look forward to reporting on our progress regularly.

Your Royalty Portfolio

ACAMBIS PLC

Summary

- Drug Royalty investment: £0.4 million in November 1997 for a royalty interest and other royalty-related interests
- Yellow Fever vaccine, Arilvax®, has completed Phase III trials; FDA submission expected in 2001
- Collaborations with Baxter, SmithKline Beecham, Pfizer, Eli Lilly, Novartis, Medeva, Aventis Pasteur, Genzyme and the U.S. Centers for Disease Control

Acambis plc. is a British biopharmaceutical company that develops vaccines to prevent and treat infectious diseases. Acambis is listed on the London Stock Exchange under the symbol ACM and on the Nasdaq Stock Exchange under the symbol ACAM.

Acambis' vaccine product candidates in clinical trials include a yellow fever vaccine, oral typhoid vaccine, H. pylori vaccine, C. difficile vaccine, smallpox vaccine, Oral ETEC vaccine and Japanese Encephalitis vaccine. Acambis has entered into alliances with major pharmaceutical companies and the U.S. Centers for Disease Control to use their capabilities and expertise to complete the regulatory development, manufacturing and marketing of products. The company also has several technology platforms that provide the basis for further vaccine product candidates.

Drug Royalty, through an agreement with the University of Birmingham, shares a percentage of Acambis' revenues.

AMGEN INC.

Summary

- Drug Royalty investment: $27.2 million in 1998 and 2000 for a percentage of worldwide revenues over eight years in the leading immune drug, Neupogen
- Worldwide sales of US$1.2 billion in 2000
- Sustained duration Neupogen, SD/01, filed for approval with FDA
- Used to prevent infection in patients by boosting the production of infection-fighting white blood cells

Amgen Inc. is the world's leading biotechnology company and trades on the Nasdaq Stock Market under the symbol AMGN. One of the company's most successful products, Neupogen, had worldwide sales in 2000 of US$1.2 billion, and for the nine months ended September 30, 2001 sales were US$990 million, an increase of 10% over the prior period. Sales of Neupogen in 2000 were negatively impacted by several factors including wholesale buying patterns and foreign exchange effects. Amgen expects 2001 sales of Neupogen to be slightly higher than 2000, and long-term sales projections for Neupogen are very positive due to prospects for sustained-duration Neupogen, which was submitted to the FDA for approval in the first quarter of 2001.

Amgen's sustained-duration Neupogen product, SD/01, will provide greater convenience and improved compliance of once-per-cycle dosing. Some equity analysts have stated that, due to its selling point of greater compliance, the product could eventually boost the market for Neupogen by as much as 40%. This is expected to be a significant market growth opportunity for Neupogen, thereby increasing royalty revenue received by Drug Royalty.

BRISTOL-MYERS SQUIBB COMPANY

Summary

- Drug Royalty investment: $15.5 million in December 1998 for a percentage of revenues over 13 years from worldwide sales of Taxol
- Largest selling anti-cancer drug with worldwide sales in 2000 of US$1.6 billion
- Continues to retain its market exclusivity in Europe; genericized in the U.S.
- Approved to treat breast, ovarian and non-small cell lung cancer, and Kaposi's sarcoma

Bristol-Myers Squibb Company (BMS) is a leading international healthcare and consumer products company which trades on the New York Stock Exchange under the symbol BMY. The company's world-leading oncology franchise includes the world's top-selling anti-cancer agent, Taxol. The product had worldwide sales of US$1.6 billion in 2000 and US$930 million for the nine months ended September 30, 2001, which represents a 23% decline over the prior period.

In October 2000, Taxol was genericized in the U.S. though Taxol continues to retain its market exclusivity outside the U.S., which currently accounts for about one half of the total sales for the drug. The ex-U.S. market for Taxol is experiencing growth at a rate of 6% to 10%, while U.S. sales are declining due to the launch of generics. Drug Royalty's original purchase price and estimated return for the BMS Taxol royalty included the anticipated financial effect of the genericization of Taxol.

The U.S. National Cancer Institute is presently engaged in 185 clinical trials using Taxol, some 48 of which are at the Phase III stage, for indications such as small cell lung, prostate, bladder, urinary tract, colon, male germ cell, peritoneal, head and neck, esophageal and endometrial cancer and cancers of unknown origin.

Drug Royalty receives a percentage of revenues on the worldwide sales of Taxol.

CAMBRIDGE ANTIBODY TECHNOLOGY GROUP PLC

Summary

- Drug Royalty investment: £1.5 million in 1994 for a 15-year royalty agreement on all revenues
- Rheumatoid arthritis antibody program, D2E7, is currently in Phase III with partner, Abbott
- Licenses and collaborative agreements with Eli Lilly, Pfizer, Wyeth-Ayerst, AstraZeneca, Human Genome Sciences, ICOS, Abbott, Oxford GlycoSciences, Pharmacia, Elan, Immunex, Merck

Cambridge Antibody Technology Group plc (CAT) is a world leader in the field of human antibodies and trades on the London Stock Exchange under the symbol CAT and the Nasdaq Stock Market under the symbol CATG. The company is using its proprietary technologies in fully human monoclonal antibodies for drug discovery and drug development.

CAT has an extensive phage display antibody library, currently incorporating 100 billion distinct antibodies. This library forms the basis for the company's strategy to develop a portfolio of clinical development programs. The company is also generating revenues through collaborations with major international pharmaceutical and biotechnology companies using their antibody-based functional genomics platform for the validation of drug targets. Five fully human therapeutic antibodies developed by CAT are at various stages of clinical trials. CAT's rheumatoid arthritis antibody program, D2E7, is currently in Phase III trials, making it the first fully human monoclonal antibody to enter this stage of clinical assessment.

Drug Royalty receives a royalty percentage on all revenues received by CAT.

CELGENE CORPORATION

Summary

- Drug Royalty investment: $4.7 million in 2001 for a percentage of revenues over 15 years in Thalomid
- Thalomid functions as an angiogenesis inhibitor (prevents the formation of new blood vessels) and a TNF-alpha inhibitor (reduces inflammation)
- Currently over 200 clinical trials in progress evaluating Thalomid in various cancer indications
- Thalomid had sales of US$62 million in 2000 with analysts predicting sales of over US$80 million in 2001

Celgene Corporation is a U.S. pharmaceutical company with a major focus on the discovery, development and commercialization of small molecule cancer and immunological disease drugs, and trades on the Nasdaq Stock Market under the symbol CELG.

Thalomid was approved by the FDA in 1998 for erythema nodosum leprosum (ENL), a complication of leprosy, but has shown significant potential in treating multiple myeloma, a cancer of the blood. Thalomid is currently involved in over 200 trials worldwide evaluating its efficacy in various cancer indications. Thalomid (thalomide) was originally launched in the 50s and 60s as a sedative and to control morning sickness but was withdrawn from the market due to resulting birth defects.

Drug Royalty receives a percentage of worldwide sales of Thalomid and expects revenues from this interest to drive growth in future earnings.

JOHNSON & JOHNSON

Summary

- Drug Royalty investment: $7 million in 2001 for a percentage of revenues over 15 years in Remicade
- Remicade is in a class called TNF-alpha inhibitors which analysts have predicted could grow to US$6 billion by 2005
- Remicade had sales of US$370 million in 2000, an increase of 219% over 1999

Johnson & Johnson is a U.S. based corporation that is engaged in the manufacture and sale of a broad range of products in the health care field. It currently trades on the New York Stock Exchange under the symbol JNJ. Johnson and Johnson is the seventh largest pharmaceutical company in the world with its pharmaceutical segment generating US$12 billion in sales for 2000.

Remicade is a monoclonal antibody that binds to tumor necrosis factor alpha (TNF-alpha) which is believed to be a central causative factor in the inflammatory process. The product had worldwide sales of US$370 million in 2000 and US$511 million for the nine months ended September 30, 2001 which represents a 121% increase over the prior period. Remicade was first approved in 1998 for Crohn's Disease and later in 1999 it obtained approval for Rheumatoid Arthritis. It is the first monoclonal antibody to reduce the signs and symptoms of this crippling disease. Analysts have predicted that the TNF-alpha class of drugs could grow to US$6 billion by 2005.

Drug Royalty acquired a royalty interest in Remicade in April 2001 and expects revenues derived from this interest to grow significantly over the life of the agreement.

PHYTOGEN LIFE SCIENCES INC.

Summary

- Drug Royalty investment: $1.5 million in 1995, $3.3 million in 1997/1998 and a further $1.2 million in 2001 for a percentage of generic Taxol revenues for 15 years
- Phytogen signed exclusive license and supply agreement in July 1996 with Mylan Laboratories, Inc., a major U.S. generic drug company
- Mylan received FDA approval to manufacture and market paclitaxel and launched its product in July 2001

Phytogen is a private company established in 1990 near Vancouver, Canada, focusing on the production of the anti-cancer drug, paclitaxel. Taxol is a registered trademark of Bristol-Myers Squibb Company's brand of paclitaxel.

Phytogen has licensed the North American marketing rights for its paclitaxel to Mylan Laboratories, Inc. Mylan received FDA approval to manufacture and market paclitaxel in July 2001, and launched its generic version of

Taxol the same month. Phytogen is in discussions with other potential marketing partners concerning worldwide development, registration, and distribution.

Drug Royalty receives a royalty percentage on all paclitaxel-related revenues received by Phytogen.

SCHERING-PLOUGH CORPORATION

Summary

- Drug Royalty investment: $7.2 million in 2000 for a percentage of worldwide revenues over 14 years in the "next generation Claritin," Clarinex
- Claritin, used for the treatment of seasonal hay fever, generated worldwide sales of US$3 billion in 2000
- European Union approval obtained in January 2001, launched in UK and Germany
- FDA approvable letter obtained February 2001, awaiting final approval

Schering-Plough Corporation is a recognized leader in biotechnology, genomics and gene therapy, and trades on the New York Stock Exchange under the symbol SGP. The company's lead product, Claritin – the largest-selling prescription hay fever product, commanding a 45% market share – had worldwide sales in 2000 of US$3 billion, and for the nine months ended September 30, 2001 sales were US$2.5 billion, an increase of 5% over the prior period.

Claritin is expected to lose its market exclusivity in the U.S. by December 2002. The active metabolite of Claritin is desloratadine (brand name Clarinex) which is patent-protected until 2014. Clarinex is a key element in Schering-Plough's strategy to protect and expand the allergy franchise established by Claritin. Schering-Plough has received final approval from the EU and launched the product in the UK and Germany in February 2001. Final approval from the FDA is expected when Schering-Plough corrects some cGMP deficiencies in two of its existing plants.

Clarinex is expected to have superior characteristics compared to competing drugs, including Claritin. Possible advantages include faster onset of action and/or higher potency. There is also some evidence that the drug may have natural decongestant activity which current competing products do not have.

Drug Royalty receives a royalty on the worldwide sales of Clarinex. These royalty revenues are expected to become a growing component of our portfolio in 2002 as Schering-Plough repositions its US$3 billion Claritin franchise onto patent-protected Clarinex.

ULTRAVISION CORP.

Summary

- Drug Royalty investment: US$2.5 million in November 1997 for a percentage of revenues over 12 years
- Worldwide sales of $17.1 million in 2000
- Initiated production in their state-of-the-art manufacturing and distribution facility in St. Hubert, Quebec
- Signed a worldwide exclusive license and supply agreement with CIBA Vision

UltraVision Corp. is a Canadian public company trading on the Canadian Venture Exchange under the symbol UVC. The company is an aggressively-growing manufacturing, distributing and marketing company of unique and innovative specialty contact lens products and technologies.

In the fall of 2001, UltraVision announced it had granted an exclusive worldwide license to CIBA Vision, the eye care unit of Novartis AG, to market UltraVision's soft contact lens product Specialty Choice A.B. The deal also included a multi-year, renewable supply agreement.

Drug Royalty receives a royalty on the worldwide revenues earned by UltraVision and its subsidiaries.

Summary of Royalty Agreements

as at October 31, 2001

Therapeutic Area	Description of Products, Companies and Territory in which our Royalty Interest Applies	Net Investment by DRC	Nature of Royalty Interest
Cancer	**Amgen Inc.** Neupogen (Worldwide revenue)	$15,406,039	□ undisclosed % of revenue on Neupogen for 8 years
	Bristol-Myers Squibb Company Taxol (Worldwide revenue)	$11,719,467	□ undisclosed % of revenue on Taxol for 13 years
	Phytogen Life Sciences Inc. Paclitaxel (Worldwide revenue)	$3,606,360	□ undisclosed % of revenue for 15 years □ 1,000,554 convertible preferred shares □ 14,600 common shares □ 175,000 preferred share warrants at $4.00 expiring on July 31, 2002 □ 426,750 common share warrants at $3.25 to $5.00 expiring up to March 10, 2007 □ 11½% three-year subordinated debenture
	Celgene Corporation Inc. Thalomid (Worldwide revenue)	$4,619,273	□ undisclosed % of revenue on Thalomid for 14 years □ effective October 5, 2001
Rheumatoid Arthritis	**Johnson & Johnson** Remicade	$6,615,377	□ undisclosed % of revenue for 15 years
Respiratory	**Schering-Plough Corporation** Clarinex (Worldwide revenue)	$7,217,562	□ undisclosed % of revenue on desloratadine for 14 years
Acute Pain	**Multinational Pharmaceutical Company** "Acute Pain" Product (European territory revenue)	$2,096,987	□ undisclosed % of revenue on "acute pain" product in a major European territory for 2.5 years
	Paladin Labs Inc. Statex® SR – OD and BD (Canadian revenue)	$10,000	□ sublicensed rights to slow-release morphine, once per day and twice per day, for an undisclosed % of revenue for 20 years □ 100,000 common share warrants exercisable at $3.00 expiring May 4, 2003
Genomics and Human Antibodies	**Cambridge Antibody Technology Group plc** Human Antibodies for various applications (Worldwide revenue)	$1,370,760	□ undisclosed % of all CAT's revenues for 15 years
Vaccines	**Acambis plc** Novel Vaccines and Drug Discovery Platform Technologies (Worldwide revenue)	$620,393	□ undisclosed % of revenues in Acambis plc □ 50,000 ordinary shares
Ophthalmology	**UltraVision Corp.** Specialty Contact Lens and Lens Care Products (Worldwide revenue)	$1,725,250	□ undisclosed % of revenues for 12 years □ 3,457 common shares
Women's Health	**Pharmacia Canada Inc.** Combination and Single Entity Hormone Replacement Patches (Canadian revenue)	$Nil	□ sublicensed rights to Combination and Single Entity Hormone Replacement Patches for Canada for undisclosed royalties
Cardiovascular	**Spectral Diagnostics Inc.** Method and Device for Diagnosing and Distinguishing Chest Pain (Worldwide revenue)	$68,998	□ undisclosed % of revenue
Miscellaneous	**Amarin Corporation** (Formerly Ethical Holdings plc) All products of Amarin (Canadian revenue)	$20,000	□ 15% of Canadian royalties generated by Amarin's products for 20 years
Other	**Public and Private Companies** Drug Delivery/Cancer/Devices	$86,255	□ various equity interests

- U.S. Food and Drug Administration (FDA) approved for prevention of infection in cancer patients undergoing chemotherapy, bone marrow transplant patients, acute myeloid leukemia patients and others suffering from various forms of neutropenia
- Neupogen is also used for AIDS-related neutropenia and patients with severe infectious disease settings such as pneumonia
- Phase III clinical trials of sustained duration Neupogen molecule, SD/01, completed. Filed BLA with FDA in Q1 2001

- FDA and European Union approved for treatment of ovarian, breast and non-small cell lung cancer, and AIDS-related Kaposi's sarcoma
- there are approximately 185 trials ongoing including 48 Phase III trials for indications such as small cell lung, bladder, prostate, urinary tract, colon, male germ cell, peritoneal, head and neck, esophageal, endometrial and cancers of unknown origin

- Phytogen passed its FDA plant inspection in July 2001; Mylan, Phytogen's licensing partner, began selling its version of generic paclitaxel in July 2001

- FDA approval for erythema nodosum leprosum (ENL), a complication of leprosy
- there are over 200 clinical trials ongoing evaluating Thalomid for indications such as multiple myeloma, colorectal cancer, myelodysplastic syndrome and renal cell cancer
- submission of sNDA expected in second half of 2001 for multiple myeloma

- FDA approved for treating moderate to severe rheumatoid arthritis (with Methotrexate), preventing RA joint damage, and preventing signs and symptoms of Crohn's Disease

- NDA for Clarinex for the treatment of seasonal allergic rhinitis was submitted to the FDA and European Union in October 1999
- European Union Committee for Proprietary Medicinal Products recommended approval of desloratadine for seasonal allergies in October 2000
- approval in the EU obtained in February 2001 with subsequent launch in the UK and Germany
- approvable letter received from FDA in January 2001, SGP needs to correct current cGMP deficiencies in two of its plants before final approval is expected

- approved acute pain product marketed in a major European territory

- Phase III clinical trials

- Phase III clinical trials of rheumatoid arthritis antibody program, D2E7
- Phase II clinical trials of glaucoma surgery antibody program
- Phase II clinical trials of autoimmunity antibody program
- Phase I clinical trials of fibrosis antibody program completed
- Phase I clinical trials of respiratory program

- Phase III clinical trials for Arilvax, a yellow fever vaccine
- Phase II clinical trials for the oral typhoid vaccine, H. pylori vaccine and Japanese Encephalitis vaccine
- Phase I clinical trials for C. difficile vaccine and Oral ETEC vaccine
- signed contract with U.S. Centers for Disease Control (CDC) for smallpox vaccine

- FDA approved contact lens products: Specialty Progressive® Disposable, Specialty T-FRP®, Specialty 55, Specialty Masquerade, Specialty T Disposable, Specialty Sport Disposable, UltraCon®, EpiCon™ and a UV blocking contact lens product line
- agreement with CIBA Vision announced September 18, 2001 for exclusive worldwide license for Specialty Choice A.B.

- Phase III clinical trials in the U.S.

- royalty-based panel tests are approved for marketing by the FDA

- products involving oral slow-release therapy and transdermal patch products in various stages of development

- primarily products in pre-commercialization phase

Financial Statements

The following discussion and analysis for the years ended August 31, 2001 and August 31, 2000 are provided by management to assist shareholders in their review of Drug Royalty Corporation Inc. It should be read in conjunction with, and is based on, the audited consolidated financial statements and accompanying notes. The financial statements are prepared in accordance with generally accepted Canadian accounting principles and all amounts are in Canadian dollars unless otherwise stated.

Drug Royalty is a publicly traded Canadian company that provides royalty-based financing to the healthcare industry. The business strategy is to acquire existing royalty streams or create new royalty agreements within the biotechnology/pharmaceutical environment. The royalties are acquired on high growth, late-stage pharmaceutical products and are based on a percentage of sales.

The Company acquires these interests based on management's assessment of the opportunities for the products, current therapeutic trends, patent life, potential market size, market competition, ability to achieve regulatory approval, scientific results and return on investment. The Company's investment review process consists of a review by the Investment Committee of significant opportunities recommended by management before seeking approval from the Board of Directors.

2001 OVERVIEW

Revenues for the year ended August 31, 2001 grew by 6.2% over 2000 levels to reach $21.1 million, compared with $19.9 million in 2000. Net earnings were $6.3 million, a 57% increase over 2000. Earnings were driven by higher total revenue, a decrease in general and administrative expenses and a lower effective tax rate. Earnings per share rose 60% to $0.16 per share, compared with $0.10 per share in 2000. Cash flow from operations amounted to $16 million or $0.39 per share in 2001. In 2000, cash flow from operations reached $14.6 million or $0.36 per share.

REVENUES

In fiscal 2001, Drug Royalty achieved royalty revenues of $19.3 million mainly from the following sources:

- acquisition of Johnson & Johnson's Remicade®
- worldwide pharmaceutical sales of Amgen's Neupogen®
- European sales of an acute pain product
- worldwide pharmaceutical sales of Bristol Myers Squibb's Taxol®
- approval and launch of generic paclitaxel

Royalty revenues in 2001 grew by 6.2% over 2000 levels. This growth is attributed to the acquisition of Remicade and organic growth in Amgen's Neupogen. Geographically, growth is coming from revenues sourced in Canada and the U.S., as follows:

	2001	2000	% Change
Canada	$ 603,660	$ 157,140	284%
U.S.	13,140,828	11,674,667	13%
International	5,603,777	6,403,062	(13%)
	$ 19,348,265	$ 18,234,869	6%

The fees and gain on sales of royalty interests of $0.5 million were primarily due to a breakup fee from a royalty acquisition which was never completed. In 2000, the fees and gain on sales of royalty interests were the result of the sale of Cambridge Antibody Technology shares for $0.6 million.

Interest and other revenues increased by 32% to $1.3 million in 2001, from $0.9 million in 2000. This is attributed to higher cash and short-term investment balances yielding higher interest revenue throughout the year.

EXPENSES

Administrative expenses amounted to $2.3 million, a decrease of 6% over 2000. Drug Royalty employed eight people at the end of fiscal year 2001, compared with nine at the end of 2000.

Amortization, write-downs and provisions totalled $10.6 million at the end of 2001, compared with $9.6 million at the end of 2000, an increase of 10%. This increase is primarily due to the addition of the Remicade royalty interest during the third quarter of 2001.

The Company recorded write-downs and provisions in the amount of $0.9 million during the year, compared with $1.5 million in 2000. Write-downs of $0.1 million were recorded against common and preferred shares. A provision of $0.7 million was established against a royalty interest to reflect an impairment in value due to the investee's ongoing financing difficulties. A provision of $0.1 million was also recorded against a royalty interest to reflect an impairment in value due to a delay in commercialization.

Write-downs and provisions against royalty interests are reviewed regularly based on clinical status, market conditions, company viability and technological assessments, but increases in the value of royalty interests are not recorded until actually realized.

The Company recorded a foreign exchange gain of $0.9 million in fiscal 2001, compared with a foreign exchange loss of $0.5 million in 2000. This is the result of a stronger Canadian currency at the end of fiscal 2001.

RESULTS OF OPERATIONS

For the year ended August 31, 2001, cash flow from operations increased to $16 million or $0.39 per share

from $14.6 million or $0.36 per share in 2000. This increase was driven by higher royalty revenues, decreases in general and administrative expenses and a lower effective tax rate.

The Company reported net earnings of $6.3 million or $0.16 per share, compared with $4 million or $0.10 per share in 2000.

CAPITAL EXPENDITURES

During 2001, the Company invested a total of $8.2 million in the acquisitions of royalty interests, resulting in holdings of $50.6 million after amortization, write-downs and provisions, compared with $53.0 million at the end of the prior year. This decrease is the result of additional amortization of newly acquired royalty interests in 2001.

During the year, the Company completed the acquisition of a royalty interest for $7 million in the sales of Johnson and Johnson's Remicade, a drug approved for Rheumatoid Arthritis and Crohn's Disease. An interest was also completed subsequent to year-end for Thalomid®, marketed by Celgene in the U.S., for $4.7 million. This drug is approved for erythema nodosum leprosum (ENL), a complication of leprosy, but is currently undergoing extensive clinical trials for various indications, primarily in the cancer field. These acquisitions were financed through existing cash. As at year-end, Drug Royalty had a cash balance of $26 million and an unused line of credit of $20 million.

In 2000, the Company invested a total of $17.4 million in new acquisitions which included an interest in the European sales of an "acute pain" product for $8.7 million and a royalty interest in Schering-Plough's Clarinex® for $7.2 million.

LIQUIDITY AND FINANCIAL RESOURCES

As at August 31, 2001, Drug Royalty's current assets exceeded its current liabilities by $29.6 million, compared with $20.8 million as at August 31, 2000. The increase in working capital is the result of increased royalty revenues coupled with a decrease in the Company's effective tax rate.

Drug Royalty ended 2001 with a healthy cash position and did not carry any debt at the end of 2001 and 2000. Future growth will be funded internally as well as through the use of the Company's credit facility.

During the year, the Company instituted a Normal Course Issuer Bid and repurchased 64,200 shares.

On June 19, 2001, the Company amended its loan agreement with a Canadian chartered bank (the "Bank"). Under the terms of the agreement, the Bank provided the Company with a 364-day revolving credit facility of $20 million or the equivalent amount in U.S. dollars (the "Term Loan") with interest charged at LIBOR plus 200 basis points. The Company and its subsidiaries have granted the Bank a general security agreement on

their respective assets. All borrowings under the Term Loan shall be repaid in equal, consecutive, monthly principal payments until the credit facility is repaid in full. As at August 31, 2001, the Company had no amounts outstanding against the Term Loan.

INVESTMENT RISK

The continued profitability of Drug Royalty is subject to a number of risk factors including, but not limited to, successful product development and commercialization by investee companies, third party funding of investee company activities, patent protection disputes, foreign currency risk, changes in tax legislation, possible default or breach of contract by investee companies, and reliance on key personnel.

The Company's assessment of product development risk and commercial success is based upon scientific, clinical and market due diligence. As many of Drug Royalty's investee companies have pre-existing agreements with development partners, assessment of the Company's return on investment includes anticipated contributions by these development partners. Investment agreements are structured to allow recovery of the invested capital over a reasonable period based on the Company's due diligence.

Drug Royalty's investment in royalty interests exposes the Company to the financial viability of the investee company. Drug Royalty is exposed to the risk of financial loss as a result of an investee company defaulting on obligations to Drug Royalty. The Company's exposure to such losses is limited to its capital outlay. The Company limits its exposure to loss by diversifying royalty interests by country, therapeutic area and company. In some cases, Drug Royalty may obtain interests in other assets in the event of default, but generally, royalty interests relate to revenues from specified products or technologies and are unsecured.

The generation of royalty revenue is generally predicated on the strength of the investee company's patent protection. Due to the highly competitive nature of the pharmaceutical industry, the potential for parallel developments of similar products and high stakes of being first to market, the validity and breadth of a patent is often challenged. Drug Royalty may hedge its exposure to some of this risk by acquiring an interest or other equity position in a competing investment.

Many of Drug Royalty's investments are made in foreign countries and the majority of its royalty agreements require payments in foreign currencies, thereby creating foreign currency exchange risk. Significant fluctuations in the foreign currencies can affect the outcome of newly acquired royalty interests as well as the revenue realized from established interests. It is management's policy to enter into foreign exchange hedges when appropriate and not to speculate on foreign currency movements.

The Company derives a significant portion of its royalty revenues from foreign jurisdictions. A change in the tax legislation or a change in any relevant tax treaty could affect Drug Royalty's profitability on a specific transaction.

Periodically, disagreements will arise on the interpretation of contracts. Management views these incidents as part of the normal course of operations. The Company's contractual rights against certain vendors, including inventors, may have limited recourse. Management minimizes the risk of such losses through its due diligence into the vendor's original patent rights on the royalty interest, the patent protection of the product and the license agreements in place.

Management has the responsibility to identify, cultivate, manage and develop new royalty interest opportunities. The loss of services of certain members of management or the investee companies could adversely affect the Company.

FUNDING RISK

The Company is dependent upon its ability to secure funding for additional royalty interest acquisitions. Drug Royalty continues to explore new sources of funding. There can be no assurance that the total required financing will be available for a specific investment, therefore, co-investing relationships may be utilized. The Company maintains strong relationships with its institutional investors to ensure ready access to capital to fund its strategic objectives.

OUTLOOK

The healthcare industry is experiencing mounting pressure to accelerate drug development, and with the weakening of the capital markets, there is a great demand for alternative sources of capital. Royalty financing offers distinct advantages to biotechnology and pharmaceutical companies. With Drug Royalty's experienced and proven management team, the Company is poised to deliver increasing revenues and earnings in the upcoming year.

In 2002, the Company expects to sustain growth in revenues from the portfolio's two newest acquisitions, Remicade and Thalomid, while also realizing growth in sales on Amgen's Neupogen, sales of generic Taxol from Phytogen Life Sciences and the launch of Schering-Plough's allergy drug Clarinex. Revenues from the interest in the "acute pain" product will terminate in mid-2002.

All of the activities of Drug Royalty are designed to build economic value for shareholders. While the results achieved may vary from year to year, our goal remains constant.

Petra Decher, Director, Finance and Secretary-Treasurer

Management's Responsibility for Financial Reporting

The accompanying consolidated financial statements of Drug Royalty Corporation Inc. have been prepared by management in accordance with accounting principles generally accepted in Canada. The most significant of these accounting principles are described in Note 2 to the financial statements.

Management is responsible for the integrity and objectivity of the financial statements. Estimates are necessary in the preparation of these statements and, based on careful judgments, have been properly reflected in the financial statements. The Company's accounting procedures and related systems of internal control are designed to provide reasonable assurance that its assets are safeguarded and its financial records are reliable. The financial information throughout the text of this annual report is consistent with the information presented in the financial statements.

The Board of Directors has appointed an Audit Committee consisting of three outside directors. The committee meets periodically during the year to review with management and the auditors any significant accounting, internal control and auditing matters and to review and finalize the annual financial statements of the Company along with the external auditors' report prior to the submission of the financial statements to the Board of Directors for final approval.

The Company's external auditors, PricewaterhouseCoopers LLP, conduct an independent examination on behalf of the shareholders, in accordance with generally accepted auditing standards, and express their opinion on the financial statements. This examination encompasses an understanding and evaluation by the auditors of the Company's accounting and internal control systems as well as the obtaining of a sound understanding of the Company's business. Their report outlines the scope of their examination and their opinion on the financial statements of the Company. The external auditors have full access to management and the Audit Committee of the Board.

James R. Webster, President
September 24, 2001

Petra Decher, Director, Finance and Secretary-Treasurer

Auditors' Report

To the Shareholders of Drug Royalty Corporation Inc.

We have audited the consolidated balance sheets of Drug Royalty Corporation Inc. as at August 31, 2001 and 2000 and the consolidated statements of earnings and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at August 31, 2001 and 2000, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP, Chartered Accountants
Toronto, Ontario
September 24, 2001

Consolidated Financial Statements

Consolidated Balance Sheets as at August 31, 2001 and 2000

	2001	2000
ASSETS		
Current Assets		
Cash and short-term investments	$ 25,862,066	$ 19,040,002
Accounts receivable	3,752,123	3,544,834
Income taxes receivable	620,289	–
Other assets	62,109	84,871
	30,296,587	22,669,707
Royalty Interests (note 3)	50,563,448	52,979,293
Capital Assets	91,762	114,996
Future Income Tax Assets (note 4)	831,168	704,818
	$ 81,782,965	$ 76,468,814
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Accounts payable and accrued liabilities	$ 732,417	$ 918,437
Income taxes payable	–	936,428
	732,417	1,854,865
Commitments and Contingent Liabilities (note 5)		
SHAREHOLDERS' EQUITY		
Capital Stock (note 6)	53,226,481	53,032,413
Retained Earnings	27,824,067	21,581,536
	81,050,548	74,613,949
	$ 81,782,965	$ 76,468,814

Signed on behalf of the Board

R. Ian Lennox, Director

Calvin R. Stiller, Director

Consolidated Statements of Earnings and Retained Earnings

For the years ended August 31, 2001 and 2000

	2001	2000
Revenues		
Royalties	$ 19,348,265	$ 18,234,869
Fees and gain on sale of royalty interests	500,172	678,337
Interest and other	1,250,443	945,752
	21,098,880	19,858,958
Expenses		
General and administration	2,328,877	2,490,036
Amortization, write-downs and provisions	10,557,308	9,642,399
Foreign exchange (gain) loss, net of financial expenses	(883,794)	612,330
	12,002,391	12,744,765
Earnings Before Income Taxes	9,096,489	7,114,193
Income taxes (note 4)	2,802,489	3,111,363
Net Earnings for the Year	6,294,000	4,002,830
Retained earnings – beginning of year	21,581,536	17,578,706
Excess of redemption price of capital stock (note 6)	(51,469)	–
Retained Earnings – End of Year	$ 27,824,067	$ 21,581,536
Basic Earnings Per Share (note 7)	$ 0.16	$ 0.10
Diluted Earnings Per Share (note 7)	$ 0.15	$ 0.10
Weighted average number of shares outstanding (note 7)	40,670,073	40,410,839

Consolidated Statements of Cash Flows

For the years ended August 31, 2001 and 2000

	2001	2000
CASH PROVIDED BY (USED IN)		
Operating Activities		
Net earnings for the year	$ 6,294,000	$ 4,002,830
Add (deduct) items not affecting cash		
Amortization, write-downs and provisions	10,557,308	9,642,399
Gain on sale of royalty interests	(6,659)	(678,337)
Gain on sale of capital assets	(7,565)	(197)
Foreign exchange (gain) loss	(900,000)	485,784
Proceeds from sale of royalty interests	86,796	1,140,929
Cash flow from operations	16,023,880	14,593,408
Future income tax assets	(126,350)	80,573
Net change in non-cash working capital balances related to operations (note 8)	(1,927,264)	2,049,606
	13,970,266	16,723,587
Financing Activities		
Repurchase of shares (note 6)	(135,586)	–
Exercise of options	278,185	200,584
Issuance of shares, net of expenses	–	(37,423)
	142,599	163,161
Investing Activities		
Purchase of royalty interests	(8,156,797)	(17,397,169)
Purchase of capital assets	(43,076)	(24,075)
Other proceeds	9,072	360
	(8,190,801)	(17,420,884)
Increase (Decrease) in Cash and Short-term Investments	5,922,064	(534,136)
Effects of foreign exchange	900,000	(485,784)
Cash and short-term investments – beginning of year	19,040,002	20,059,922
Cash and Short-term Investments – End of Year	$ 25,862,066	$ 19,040,002

1. NATURE OF THE COMPANY

Drug Royalty Corporation Inc. ("Drug Royalty" or "Company") is a public company incorporated under the Canada Business Corporations Act and is currently trading on The Toronto Stock Exchange (TSE). Drug Royalty provides unique financial solutions to life science organizations in return for royalty interests. The Company's operations are located in North America from which it seeks opportunities worldwide.

2. ACCOUNTING POLICIES

Principles of consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, DRC USA, Inc. and Drug Royalty USA, Inc. All inter-company transactions have been eliminated.

Use of significant accounting estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Revenue

Royalty revenue is recognized as earned, according to the terms of contracts entered into with life science organizations. Royalty revenue includes a percentage of licence fees, milestone payments, royalties and sales revenue. Other revenue is recognized when amounts are realized with respect to other contractual entitlements and sales of shares, warrants or royalty interests when earned and when receipt is reasonably assured.

Cash and cash equivalents

The Company considers investments purchased with original maturities of three months or less to be cash equivalents.

Royalty interests

Royalty agreements are recorded at cost and are amortized over their expected useful lives using the straight-line method coincident with the commencement of royalty revenue from commercialized products. The revenue-producing interests from commercialized products are amortized over a period of 1 to 13 years based on current market projections and technological assessment. In circumstances when revenue is earned as a percentage of licence fees and milestone payments from products in pre-clinical and clinical development stages, royalty interests are amortized to the extent of revenue recognized, until the commencement of commercial production. Provisions are made when possible impairment is identified with respect to royalty interests. Write-offs are made when it is determined that the carrying amount will not be recoverable over the remaining life of the agreement.

In certain transactions, the Company may receive other royalty-related interests, which are recorded at cost. Such interests include common shares, preferred shares, warrants and debentures. When there has been a loss in value that is other than temporary in nature, a write-down is established. Gains and losses on disposition of royalty-related interests are recorded when realized.

The recoverability of expenditures on royalty interests is uncertain, and is dependent upon regulatory approval and commercial viability of the products under royalty agreement and on the ability of the developer to bring the products to market.

Fair value of financial instruments

Fair value represents the amount at which a financial instrument could be exchanged in an arm's length transaction between willing parties under no compulsion to act, and is best evidenced by a quoted market price.

The fair value of revenue-producing royalty interests is not practicable to determine with sufficient reliability due to the uncertain nature of the revenue streams. Therefore, no attempt to disclose this information has been made.

The fair value of the royalty-related interests is based on quoted market prices for those of similar interests. For companies that are privately held, there is no quoted market price for these interests and a reasonable estimate of fair value cannot be made without incurring excessive costs.

The Company's estimate of the fair value of other financial instruments not separately disclosed approximates their carrying value, due to the immediate or short-term maturity of these financial instruments.

Foreign exchange

Monetary assets and liabilities of domestic companies and the integrated foreign subsidiaries, which are denominated in foreign currencies, are translated into Canadian dollars at the year-end exchange rate. Non-monetary assets are translated at historical rates, and foreign currency transactions are translated at the exchange rate in effect on the transaction date. Gains and losses resulting from translation are included in the consolidated statement of earnings in the year in which they arise. Gains and losses on hedges of foreign currency transactions are included as part of the Canadian dollar price of assets purchased.

Capital assets

Capital assets are recorded at cost and amortized on a straight-line basis over their estimated useful lives:

Computer equipment	- 30%
Furniture and fixtures	- 20%
Office equipment	- 20%
Leasehold improvements	- term of lease

Income taxes

The Company has adopted the asset and liability method of accounting for income taxes. Under the asset and liability method, future tax assets and liabilities are provided for all significant temporary differences between the financial statement and tax bases of assets and liabilities and are adjusted for tax rate changes as they occur.

Stock-based compensation plan

The Company has a stock-based compensation plan as described in note 6. Stock options are issued at an exercise price no less than the market value of the Company's shares at the date of issuance. No compensation expense is recognized when stock options are issued. Consideration paid on the exercise of stock options is credited to share capital.

3. ROYALTY INTERESTS

	2001		
	Cost	Accumulated Amortization	Net
Royalty agreements			
Revenue-producing (a)(e)	$ 67,039,772	$ 27,342,704	$ 39,697,068
Non-revenue producing (f)	8,118,969	232,182	7,886,787
Royalty-related interests			
Public companies (c)(d)	173,233	–	173,233
Private companies (b)(d)	3,606,360	–	3,606,360
	$ 78,938,334	$ 27,574,886	51,363,448
Current provision (e)(f)			(800,000)
			$ 50,563,448

	2000		
	Cost	Accumulated Amortization	Net
Royalty agreements			
Revenue-producing (h)(i)	$ 60,137,158	$ 16,983,532	$ 43,153,626
Non-revenue producing (j)	8,118,969	132,182	7,986,787
Royalty-related interests			
Public companies (k)(l)(m)(p)	139,047	–	139,047
Private companies (m)	2,580,000	–	2,580,000
	$ 70,975,174	$ 17,115,714	53,859,460
Current provision (n)(o)			(880,167)
			$ 52,979,293

During the year ended August 31, 2001:

(a) The Company acquired, for $6.9 million, a royalty interest in the sales of the rheumatoid arthritis drug Remicade®, marketed by Johnson & Johnson in the U.S. and Schering-Plough Corporation outside the U.S.

(b) The Company acquired, for $1.2 million, an additional interest in a private company.

(c) The Company sold certain royalty-related interests for $0.1 million.

(d) Write-downs of $0.1 million were recorded against common and preferred shares of royalty-related interests.

(e) A provision of $0.7 million was established against a royalty interest to reflect an impairment in value due to difficulties of the investee in obtaining financing.

(f) A provision of $0.1 million was established against a royalty interest to reflect an impairment in value due to a delay in commercialization.

(g) The fair value of royalty-related interests in public companies was $0.3 million as at August 31, 2001.

During the year ended August 31, 2000:

(h) The Company acquired, for $8.7 million, a royalty interest in the European sales of an undisclosed European product from a multinational pharmaceutical company.

(i) The Company acquired, for $1.4 million, an additional royalty interest in the worldwide revenues of Amgen Inc.'s drug Neupogen®.

(j) The Company acquired, for $7.2 million, a royalty interest in the sales of an allergy drug, Clarinex®, that has been filed for market approval to the Food and Drug Administration (FDA) by Schering-Plough Corporation. The Company also has a contingent liability, for $1.8 million, if certain milestones are achieved. (See note 5(b).)

(k) The Company acquired other royalty interests for $0.1 million.

(l) The Company sold certain royalty interests for $1.1 million. The royalty interests had a carrying value of $0.5 million.

(m) Write-downs of $0.7 million were recorded against common and preferred shares of royalty-related interests.

(n) A provision of $0.1 million was established against a royalty interest to reflect an impairment in value due to a delay in achieving projected sales.

(o) A provision of $0.8 million was established against a royalty interest to reflect an impairment in value due to a delay in commercialization.

(p) The fair value of royalty-related interests in public companies was $0.5 million as at August 31, 2000.

4. INCOME TAXES

(a) Provision for income taxes for the years ended August 31 comprised the following:

	2001	2000
Current income taxes	$ 2,928,839	$ 3,030,790
Future income taxes	(126,350)	80,573
	$ 2,802,489	$ 3,111,363

(b) The major factors that caused variations from the Company's combined federal and provincial statutory income tax rate of 43% (45% in 2000) applicable to earnings before income taxes for the years ended August 31 were as follows:

	2001	2000
Provision for income taxes based on the statutory tax rate	$ 3,911,490	$ 3,201,387
Non-taxable portion of foreign exchange gain/loss and gain/loss on sale of royalty interests	(296,126)	76,692
Non-taxable portion of write-downs and provisions on royalty interests	–	213,900
Benefit of amortization of share issue expenses not previously recognized	(126,289)	(122,991)
Benefit of lower tax rate in foreign jurisdiction	(665,984)	(305,650)
Other	(20,602)	48,025
Income taxes	$ 2,802,489	$ 3,111,363

(c) The components of the future income tax assets as at August 31 were as follows:

	2001	2000
Royalty interests	$ 579,605	$ 363,210
Common share issuance costs	242,473	368,762
Other	9,090	(27,154)
	$ 831,168	$ 704,818

5. COMMITMENTS AND CONTINGENT LIABILITIES

(a) Commitments

The Company has annual lease commitments inclusive of operating costs until March 31, 2002 of $36,431.

(b) Contingent liabilities

In December 1999 the Company entered into an agreement to purchase a royalty interest. The Company has a contingent liability to pay an additional $1.8 million if the royalty rate was to increase during the first two years of commercial sale of the product. As at August 31, 2001 the product had not reached commercialization.

6. CAPITAL STOCK

(a) Authorized

Unlimited number of common shares

Unlimited number of preferred shares issuable in series

(b) Issued

	Common Shares	
	Number	Amount
Balance at August 31, 1999	40,253,548	$ 52,869,252
Issued for cash by private placement	–	(37,423)
Issued upon exercise of options	195,458	200,584
Balance at August 31, 2000	40,449,006	53,032,413
Issued upon exercise of options	**239,000**	**278,185**
Common shares repurchased	**(64,200)**	**(84,117)**
Balance at August 31, 2001	**40,623,806**	**$ 53,226,481**

During the year ended August 31, 2001, the Company repurchased 64,200 of its common shares under a Normal Course Issuer Bid for a total consideration of $135,586 ($Nil in 2000); the amount in excess of the book value of the common shares was charged to retained earnings. All shares repurchased by the Company pursuant to its Normal Course Issuer Bid will be cancelled. The Company has undertaken the Normal Course Issuer Bid pursuant to the rules and policies of the TSE. The issuer bid provides that the Company may repurchase, at the market price, up to 2,836,950 of its common shares, representing 10% of its public float.

(c) Stock options

Under the amended and restated stock option plan, introduced in 1998, the Company is permitted to issue to directors, officers and employees up to 3,790,500 common shares. The exercise price of the options granted under the plan is determined by the Board of Directors of the Company and cannot be lower than the market value on the date the options are granted. The options currently outstanding are exercisable at prices ranging from $1.00 to $2.30 at various dates, up to October 3, 2010, with a weighted average remaining contractual life of 5.7 years. Performance options vest over five years if certain performance milestones are met, retention options vest if the holder owns shares of the Company for three consecutive years, and service options vest over three to five years.

	Number	Weighted Average Exercise Price
Balance at August 31, 1999	2,806,000	$ 1.64
Options granted	289,600	1.78
Options exercised	(195,458)	1.03
Options cancelled	(216,142)	1.76
Balance at August 31, 2000	2,684,000	1.80
Options granted	**575,000**	**1.70**
Options exercised	**(239,000)**	**1.16**
Options cancelled	**(89,334)**	**1.99**
Balance at August 31, 2001	**2,930,666**	**$ 1.59**
Exercisable at August 31, 2001	**2,241,162**	**$ 1.71**

The following table summarizes information about the stock options outstanding at August 31, 2001:

	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number of Exercisable Options	Weighted Average Exercise Price
Range of exercise prices					
$1.00 - $1.49	507,500	2.55	$ 1.10	507,500	$ 1.10
$1.50 - $1.99	1,429,833	6.85	$ 1.71	883,663	$ 1.72
$2.00 - $2.30	993,333	5.64	$ 2.07	849,999	$ 2.07

7. EARNINGS PER SHARE

Effective January 1, 2001, the Company adopted the new recommendations of The Canadian Institute of Chartered Accountants with respect to the calculation of earnings per share. Basic earnings per share are based upon the weighted average number of shares outstanding during the year. Diluted earnings per share have been computed based on the weighted average of the number of shares outstanding after giving effect to the exercise of all outstanding options to acquire common shares and the funds derived thereon were utilized to repurchase shares. These recommendations have been applied retroactively. There is no impact on the 2000 diluted earnings per share.

For the year ended August 31, 2001:

	Income (Numerator)	Shares (Denominator)	Per Share Amount
Net income	$ 6,294,000	40,670,073	$ 0.16
Effect of dilutive securities:			
Stock options exercised		2,850,664	
Shares repurchased		(2,547,690)	
Diluted earnings per share	$ 6,294,000	40,973,047	$ 0.15

For the year ended August 31, 2000:

	Income (Numerator)	Shares (Denominator)	Per Share Amount
Net income	$ 4,002,830	40,410,839	$ 0.10
Effect of dilutive securities:			
Stock options exercised		1,371,833	
Shares repurchased		(996,136)	
Diluted earnings per share	$ 4,002,830	40,786,536	$ 0.10

8. SUPPLEMENTARY CASH FLOW INFORMATION

(a) Net change in non-cash working capital balances related to operations for the years ended August 31 comprised the following:

	2001	2000
Accounts receivable	$ (207,289)	$ (929,172)
Income taxes	(1,556,717)	3,030,979
Other assets	22,762	(22,202)
Accounts payable and accrued liabilities	(186,020)	(29,999)
	$ (1,927,264)	$ 2,049,606

(b) Summary of interest and income taxes received and paid for the years ended August 31:

	2001	2000
Interest received	$ 1,263,295	$ 932,535
Income taxes received	$ –	$ 1,921,777
Income taxes paid	$ 4,485,556	$ 1,630,562

9. BANK INDEBTEDNESS

On June 19, 2001, the Company amended an agreement with a Canadian chartered bank (the "Bank"). Under this amended agreement, the Bank provided the Company with a 364-day revolving credit facility of $20 million or the equivalent amount in U.S. dollars (the "Term Loan") with interest charged at LIBOR plus 200 basis points. The Company and its subsidiaries have granted the Bank a general security agreement on their respective assets. All borrowings outstanding under the Term Loan shall be repaid in equal, consecutive, monthly principal payments until the credit facility is repaid in full. As of August 31, 2001, the Company had no amounts outstanding against the facility and had $20 million of credit available.

10. RELATED PARTY TRANSACTIONS

Transactions with related parties occur in the normal course of business and are reflected at the amounts agreed to by the parties. During the year ended August 31, 2001, the Company paid consulting fees of $1,000 ($500 in 2000) to a director.

11. SEGMENTED REPORTING

The Company's operations consist primarily of acquiring and creating royalty interests which constitutes a single operating segment. The operations can be attributed to geographic regions of Canada, the U.S. and International, based on the location of the royalty interests.

(a) Revenues for the years ended August 31 were as follows:

	2001	2000
Canada	$ 1,275,398	$ 380,730
U.S.	14,219,705	12,484,063
International	5,603,777	6,994,165
Total	$ 21,098,880	$ 19,858,958

(b) Capital assets for the years ended August 31, 2001 and 2000 were $91,762 and $114,996, respectively, in Canada.

(c) Net book value of royalty interests as at August 31 was as follows:

	2001	2000
Canada	$ 3,771,613	$ 2,731,480
U.S.	42,683,694	41,807,365
International	4,108,141	8,440,448
Total	$ 50,563,448	$ 52,979,293

During the year ended August 31, 2001, revenues from the Company's three largest royalty interests amounted to 33%, 21% and 21% of revenues. In the year ended August 31, 2000, revenues from the Company's four largest royalty interests amounted to 29%, 22%, 17% and 16% of revenues.

12. DERIVATIVE FINANCIAL INSTRUMENTS

The Company has only limited involvement with derivative instruments and does not use them for speculative purposes. They are used to manage well-defined foreign exchange risks out of the normal course of business. The Company enters into forward foreign exchange contracts and options to hedge accounts receivable and future revenues denominated in U.S. dollars, and various other currencies.

At August 31, 2001, the Company had forward foreign exchange contracts to sell French francs for U.S. dollars in the amount of $2.9 million outstanding ($8.2 million in 2000) at an exchange rate of 6.51 over the next ten months. The market value of the forward foreign exchange contracts outstanding at August 31, 2001 was such that if these contracts had been closed out at August 31, 2001, the Company would have recorded a gain of $436,000. Unrealized gains and losses on outstanding forward foreign exchange contracts for accounts receivable are recorded in the financial statements, but are not recorded in the financial statements for hedges against future foreign currency revenue.

The Company does not anticipate any material adverse effect on its financial position resulting from its involvement in these types of contracts, nor does it anticipate non-performance by counterparties. The Company only deals with highly rated counterparties, normally major financial institutions.

13. SUBSEQUENT EVENT

On October 5, 2001, the Company acquired a royalty interest, for $4.7 million, in the drug Thalomid® marketed by Celgene.

BOARD OF DIRECTORS

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J. Stanley Johnson Professor
and Professor of Chemistry Emeritus
California Institute of Technology

Gregory D. Gubitz [1, 4]
Senior Vice-President
MDS Capital Corp.

R. Ian Lennox [2, 3, 4]
Chairman
Drug Royalty Corporation Inc.
President and CEO
MDS Drug Discovery & Development Sector

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Associate Partner
IMI Consulting GmbH.

Sir Brian Richards PhD [3]
Retired Co-founder
British Biotech plc

Calvin R. Stiller MD, FRCP(C) [2, 4]
Chairman and Chief Executive Officer
Canadian Medical Discoveries Fund Inc.

Mark Vincent MB, ChB, MRCP (UK), FRCP(C) [2]
Staff Medical Oncologist
London Regional Cancer Centre,
London, Ontario

James R. Webster [2, 4]
President
Drug Royalty Corporation Inc.

David A. Williams [1, 4]
President
Roxborough Holdings Limited

MANAGEMENT AND CORPORATE OFFICERS

James R. Webster
President

Harry K. Loveys [2]
Executive Vice-President

John McCulloch PhD
Vice-President, Technology

Petra Decher
Director, Finance and Secretary-Treasurer

Shermaine Tilley PhD
Director, Biotechnology/Pharmaceutical Research

Committees

1 Audit Committee
The principal responsibility of this committee relates to the review of the annual consolidated financial statements, accounting practices and policies, and results of external audits and related matters; assessing internal control programs and policies; examining the fees and expenses for audit services; and recommending external auditors for appointment by shareholders.

2 Investment Committee
The purpose of this committee is to consider royalty-based investment proposals prior to presentation to the full Board of Directors for approval. The composition of the committee gives consideration to individual members' expertise in pharmaceutical regulatory issues, clinical trials, drug development, drug delivery technology, medical research and business issues.

3 Compensation Committee
The responsibility of this committee is to review the overall compensation strategy, objectives and policies; review performance assessments of senior management; and confirm the adequacy and form of executive and director compensation.

4 Executive Committee
The purpose of this committee is to formulate and review the strategy and overall policies of Drug Royalty.

CORPORATE HEADQUARTERS

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Chartered Accountants
Toronto, Ontario

TRANSFER AGENT AND REGISTRAR

Computershare Investor Services
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Toronto, Ontario M5J 2Y1

LEGAL COUNSEL

Fasken Martineau DuMoulin LLP
Toronto, Ontario

STOCK SYMBOL

Common shares listed on the Toronto Stock Exchange
Symbol: DRI

INQUIRIES

Petra Decher
Director, Finance and Secretary-Treasurer

ANNUAL MEETING

The annual meeting of shareholders will take place at 10:00 a.m. on Tuesday, February 12, 2002 at the Toronto Stock Exchange Conference Centre

COMMON STOCK TRADING RANGE

	2000 - 2001			1999 - 2000		
For the Fiscal Period	High	Low	Volume	High	Low	Volume
September - November	$ 2.05	$ 1.51	3,108,065	$ 2.05	$ 1.35	1,688,683
December - February	2.25	1.65	2,024,263	2.40	1.32	5,700,156
March - May	2.15	1.76	1,694,435	3.46	1.70	3,622,725
June - August	2.16	1.96	1,726,662	2.15	1.60	985,295

QUARTERLY INFORMATION

2001 ($000)	**Quarter 1**	**Quarter 2**	**Quarter 3**	**Quarter 4**	**Total**
Revenue	**5,542**	**5,299**	**5,022**	**5,236**	**21,099**
Expenses:					
General and administrative	**646**	**563**	**547**	**573**	**2,329**
Amortization, writedowns and provisions	**2,418**	**2,320**	**2,464**	**3,355**	**10,557**
Financial	**5**	**2**	**5**	**(896)**	**(884)**
Income Taxes	**1,030**	**902**	**723**	**148**	**2,803**
Net Earnings	**1,443**	**1,512**	**1,283**	**2,056**	**6,294**
Cash Flow from Operations	**3,946**	**3,820**	**3,747**	**4,511**	**16,024**

2000 ($000)	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Total
Revenue	3,409	5,346	4,753	6,351	19,859
Expenses:					
General and administrative	598	647	582	663	2,490
Amortization, writedowns and provisions	1,436	2,658	2,484	3,064	9,642
Financial	28	575	1	8	612
Income Taxes	556	674	694	1,188	3,112
Net Earnings	791	792	992	1,428	4,003
Cash Flow from Operations	2,227	4,355	3,516	4,495	14,593

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